

FINANCIAL STATEMENTS

Houston Endowment Inc.
Years Ended December 31, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Houston Endowment Inc.

Financial Statements

Years Ended December 31, 2015 and 2014

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Report of Independent Auditors

The Board of Directors
Houston Endowment Inc.

We have audited the accompanying financial statements of Houston Endowment Inc. (the Foundation), which comprise the statements of assets and fund balance – federal excise tax basis as of December 31, 2015 and 2014, and the related statements of revenues, expenditures, and changes in fund balance – federal excise tax basis for the years then ended, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with the basis of accounting used for federal excise tax purposes described in Note 1; this includes determining that the basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management also is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and fund balance of the Foundation as of December 31, 2015 and 2014, and its revenues, expenditures, and changes in fund balance for the years then ended, on the basis of accounting described in Note 1.

Federal Excise Tax Basis of Accounting

As described in Note 1 to the financial statements, the financial statements have been prepared by the Foundation on the basis of accounting used for federal excise tax purposes, which is a basis of accounting other than U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Ernst + Young LLP

November 7, 2016

Houston Endowment Inc.

Statements of Assets and Fund Balance – Federal Excise Tax Basis

	December 31	
	2015	2014
Assets		
Cash, cash equivalents, and short-term investments	\$ 55,934,950	\$ 26,018,423
Marketable securities	56,972,849	52,331,208
Other investments	1,281,693,658	1,332,822,127
Real property	323,234	406,593
Other assets	2,047,756	1,513,535
Total assets	<u>\$ 1,396,972,447</u>	<u>\$ 1,413,091,886</u>
Fund balance		
Appropriated for grants payable in future years	\$ 72,181,927	\$ 57,111,133
Unappropriated fund balance	1,324,790,520	1,355,980,753
Total fund balance	<u>\$ 1,396,972,447</u>	<u>\$ 1,413,091,886</u>

See accompanying notes.

Houston Endowment Inc.

Statements of Revenues, Expenditures, and Changes
in Fund Balance – Federal Excise Tax Basis

	Year Ended December 31	
	2015	2014
Revenues:		
Partnership income	\$ 14,993,030	\$ 25,881,239
Royalties and rents	3,326,342	4,263,893
Interest	989,906	1,271,272
Dividends	52,977	4,291
Other income	12,105	27,969
	<u>19,374,360</u>	<u>31,448,664</u>
Expenditures:		
Investment expenses	27,342,766	30,705,370
Administrative expenses	7,038,158	6,742,180
Federal excise taxes	2,002,729	2,198,508
	<u>36,383,653</u>	<u>39,646,058</u>
Revenues, less expenditures before grant payments	(17,009,293)	(8,197,394)
Grant payments	62,666,212	85,843,060
Grant refunds	(3,478,734)	(15,779)
Excess of expenditures over revenues	<u>(76,196,771)</u>	<u>(94,024,675)</u>
Fund balance at beginning of year	1,413,091,886	1,387,689,832
Realized capital gains	60,077,332	119,426,729
Fund balance at end of year	<u>\$1,396,972,447</u>	<u>\$1,413,091,886</u>

See accompanying notes.

Houston Endowment Inc.

Notes to Financial Statements

December 31, 2015

1. Significant Accounting Policies

Reporting Entity

Houston Endowment Inc. (the Foundation) was incorporated in 1937 as a nonprofit organization for the purpose of supporting charitable, educational, and religious undertakings. The Foundation invests its endowment funds and uses the return from the investments to make grants to charitable organizations.

Basis of Accounting

The Foundation reports on the federal excise tax basis of accounting. Revenues are recognized when cash is received or recognized for tax purposes, and expenditures are recognized when cash is disbursed or recognized for tax purposes. Accordingly, grants to charitable organizations are recognized as expenditures when paid. Accounts do not include interest and dividends receivable, amortization of bond premiums, accretion of bond discounts, federal excise tax payable, or other liabilities, unless subject to federal excise tax in the current period. Purchases or sales of investments are recorded at trade date, with payables or receivables from such transactions reflected as settled in cash on the trade date.

Cash, Cash Equivalents, and Short-Term Investments

The Foundation considers all highly liquid investments having original maturities of three months or less to be cash equivalents and all investments having original maturities of one year or less to be short-term investments.

Marketable Securities

Marketable securities are recorded at cost on the date of acquisition.

Other Investments

Other investments include nonmarketable securities, such as limited partnerships of private equity, real estate and alternative investments, and are recorded at cost on the date of acquisition. As of December 31, 2015, 43% of the portfolio was held in vehicles utilizing lock-ups of 12 months or shorter and 73% of the portfolio was held in vehicles utilizing lock-ups of 60 months or shorter.

Houston Endowment Inc.

Notes to Financial Statements (continued)

1. Significant Accounting Policies (continued)

As of December 31, 2015, the Foundation held investments under the direction of various fund managers, with the largest concentration of investments managed by Investure. Investments at cost managed by Investure as of December 31, 2015 and 2014, were as follows:

	<u>2015</u>	<u>2014</u>
Investure Global Equity Fund, LP	\$ 380,775,478	\$ 470,305,583
Investure Emerging Markets Fund, LP	124,369,594	115,037,259
Investure Evergreen Fund, LP	199,363,648	146,798,454
Investure Alternative Fund, Ltd.	329,063,377	322,000,000
Parametric Global Equity	8,702,216	–
Total investments managed by Investure	<u>\$1,042,274,313</u>	<u>\$1,054,141,296</u>

Other than the investments listed above, there were no investments held by the Foundation that represented more than 5% of the Foundation's fund balance as of December 31, 2015 and 2014. The Foundation had unfunded commitments to make additional partnership investments of approximately \$245 million at December 31, 2015. The timing of the funding of such commitments will vary from year to year based on the specific capital requirements of the partnerships.

Real Property

Investments in real property are recorded at cost.

Other Assets

Other assets (including leasehold improvements, furniture, equipment, and software used in the operations of the Foundation) are recorded at cost. Where appropriate, these assets are depreciated using the straight-line method based on their estimated useful lives.

Houston Endowment Inc.

Notes to Financial Statements (continued)

1. Significant Accounting Policies (continued)

Fund Balance

Grants approved to be paid in a future year are reflected as appropriated fund balance until paid. Unappropriated fund balance includes the amount of the original endowment, gains recognized on sales and other dispositions of assets, and net revenues in excess of expenditures. Realized net capital gains are added directly to the unappropriated fund balance.

Federal Excise Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986 and, accordingly, is not subject to federal income tax on investment income. However, the Foundation is classified as a private foundation and is subject to an excise tax on net investment income. For 2015, the Foundation will pay excise taxes at the rate of 2% of net investment income, equaling approximately \$1.2 million. For 2014, the Foundation satisfied certain requirements as to the level of distributions to charitable organizations and therefore qualified to pay excise taxes at the rate of 1% of net investment income, equaling approximately \$1.2 million.

Consistent with a federal excise tax basis of accounting, federal excise taxes are recorded when estimated payments are made, final payments are made, or refunds are received. Accordingly, federal excise tax expense on the statements of revenues, expenditures, and changes in fund balance may be substantially more or less than the actual tax attributable to any individual year.

2. Retirement Benefits

The Foundation has a defined-benefit pension plan covering its employees. The Foundation made a contribution of \$600,000 in 2015 and 2014. The defined-benefit pension plan is funded in amounts sufficient to meet the minimum requirements of the Employee Retirement Income Security Act of 1974. As of October 1, 2015, the date of the latest actuarial valuation, the Adjusted Funding Target Attainment Percentage, as defined by the Pension Protection Act of 2006, was 101%.

Houston Endowment Inc.

Notes to Financial Statements (continued)

2. Retirement Benefits (continued)

The Foundation also has a voluntary defined-contribution plan that provides retirement benefits to participating employees. Employees are eligible for participation upon completion of 30 days of continuous service. The Foundation's contributions are based upon a percentage of employee contributions. The Foundation's contributions to the plan were \$121,662 and \$123,091 in 2015 and 2014, respectively.

3. Lease Obligations

In 2011, the Foundation amended the existing lease for office space to provide for an extension of the lease term for 10 years, with up to 20 years in renewal options. Future minimum rental payments under the noncancelable operating lease for office space for the next five years and thereafter and in the aggregate are as follows:

Year ending December 31:	
2016	\$ 616,334
2017	616,333
2018	616,333
2019	621,846
2020	632,872
Thereafter	<u>1,054,786</u>
Total	<u>\$ 4,158,504</u>

4. Grants Appropriated for Payment in Future Years

As previously noted, grants approved are recorded as appropriated fund balance until paid and they are recognized as expenditures when paid. Grants appropriated for payment in future years as of December 31, 2015 and 2014, were as follows:

	<u>2015</u>	<u>2014</u>
Appropriated for grants payable in future years at beginning of year	\$ 57,111,133	\$ 80,851,519
Grants approved	77,737,006	62,102,674
Grants paid	<u>(62,666,212)</u>	<u>(85,843,060)</u>
Appropriated for grants payable in future years at end of year	<u>\$ 72,181,927</u>	<u>\$ 57,111,133</u>

Houston Endowment Inc.

Notes to Financial Statements (continued)

4. Grants Appropriated for Payment in Future Years (continued)

The Foundation estimates that the appropriated for grants payable in future years balance as of December 31, 2015 will be paid as follows:

Year ending December 31:	
2016	\$ 47,198,783
2017	17,453,580
2018	5,404,564
2019	1,375,000
2020	750,000
Total	<u><u>\$ 72,181,927</u></u>

5. Adjustments to Prior Year Activity

During the year ended December 31, 2015, the Company identified errors associated with the treatment of certain partnership distributions for the two years ended December 31, 2014. Partnership distributions of \$23.2 million were recognized as capital gains rather than as a decrease in the basis of these partnerships. Consequently, we have corrected the errors in the accompanying financial statements for the year ended December 31, 2015 by decreasing the book value of investments by \$23.2 million and decreasing realized capital gains by the same amount.

For the year ended December 31, 2013, the Company reported other investments of \$1.26 billion and realized capital gains of \$75.6 million. As a result of this correction, other investments should have been \$1.25 billion, and realized capital gains should have been \$65.0 million. For the year ended December 31, 2014, the Company reported other investments of \$1.33 billion and realized capital gains of \$119.4 million. As a result of this correction, other investments should have been \$1.32 billion, and realized capital gains should have been \$106.9 million. The correction of these errors is not material to our previously reported financial statements for the years ending December 31, 2013 and 2014.

6. Subsequent Events

The Foundation has evaluated subsequent events through November 7, 2016, the date the Foundation's financial statements were available for issuance.

Houston Endowment Inc.

Notes to Financial Statements (continued)

7. Market Value of Assets (Unaudited)

The statements of assets and fund balance and the related statements of revenues, expenditures, and changes in fund balance do not include any unrealized gains or losses due to changes in the market value of assets.

At December 31, the market value of the Foundation's assets is as follows:

	<u>2015</u>	<u>2014</u>
Cash, cash equivalents, and short-term investments	\$ 56,047,307	\$ 26,018,423
Marketable securities and related receivables	57,516,976	53,598,787
Other investments	1,541,061,554	1,633,990,923
Real property	27,751,321	28,302,401
Other assets	1,945,967	1,536,146
Total assets	<u>\$ 1,684,323,125</u>	<u>\$ 1,743,446,680</u>

Market values of marketable securities and short-term investments are based upon published quotations. Receivables are stated at the accrued amount. The market value of other investments and assets is determined by management.

The value of real property is determined by independent appraisers and is updated at least every five years.

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